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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1483

NATIONAL AUTOMOBILE DEALERS ASSOCIATION, INC.
Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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Petitioner, National Automobile Dealers Association, Inc. ("NADA")*, prays that a writ of certiorari issue to review the judgment rendered in this case by the United States Court of Appeals for the District of Columbia Circuit.

OPINIONS BELOW

On October 13, 1976, the Board of Governors of the Federal Reserve System (the "Board") adopted an order/rule that bank holding companies should be permitted to engage in automobile leasing under Section 4(c)(8) of

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* NADA represents some 20,000 franchised automobile and truck dealers. Many of its members engage in automobile leasing as part of their merchandising business and are thus impacted by the ruling for which review is sought.

the Bank Holding Company Act of 1956, as amended, 12 U.S.C. § 1843(c)(8). The Board's order was reproduced at 41 Fed. Reg. 45977-85 (1976), and appears as Appendix A to this petition.

Timely appeal of the order was filed by petitioner in the United States Court of Appeals for the District of Columbia Circuit. That court affirmed the order on February 21, 1978. The judgment of the court of appeals, issued without opinion, is not reported, and appears as Appendix B hereto.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

Automobile leasing is a relatively new and growing form of automobile merchandising. Because of the high residual value (resale value) of the leased vehicle at term end and the high amount of turnover, automobile lessors are directly involved, on a regular basis, in the purchase and sale of new and used automobiles and in projecting residual values.

The Board has approved the performance of this activity by bank holding companies under a "full pay-out" formula which provides, in part, that bank holding company lessors may attribute up to 60% of acquisition cost to a lessee guarantee of residual value, for "full pay-out" purposes. The Consumer Leasing Act of 1976 effectively limits a consumer lessee's guarantee liability to an amount not to exceed the product of three times the monthly rental.

The questions presented in this case are as follows:

1. Whether bank holding companies are authorized, under Section 4(c)(8) of the Bank Holding Company

Act which permits bank holding companies to engage in activities that are "closely related to banking", to enter the automobile leasing business, a commercial activity necessarily involving the marketing of new and used cars.

2. Whether that portion of the Board's "full pay-out" formula permitting attribution of up to 60% of acquisition cost for a lessee guarantee of residual value remains valid in the face of a federal statute limiting a consumer lessee's guarantee liability to a much smaller amount.

STATUTES AND REGULATION INVOLVED

The statutory provisions involved in this proceeding are Section 4(c)(8) of the Bank Holding Company Act of 1956, as amended, 12 U.S.C. § 1843(c)(8) (1970) and the lessee liability provision of the Consumer Leasing Act of 1976, 15 U.S.C. § 1667b(a) (Supp. VI, 1976). These statutory sections appear as Appendix C to this petition.

The administrative regulation involved is Section 225.4(a)(6)(i) of the Board's Regulation Y, 12 C.F.R. § 225.4(a)(6)(i) (1977). It appears as Appendix D hereof.

STATEMENT OF THE CASE

The jurisdiction of the court of appeals was invoked pursuant to the judicial review provision of the Bank Holding Company Act, 12 U.S.C. § 1848 (1970).

Pursuant to public notice,[1] the Board conducted rule-making proceedings in 1975-76[2] on whether automobile

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[1] See 40 Fed. Reg. 5372 (1975) and 41 Fed. Reg. 4022 (1976).

[2] These proceedings were the result of an earlier appeal of Board action by NADA. On March 27, 1974, the Board adopted a personal property leasing rule designating those personal property leasing activities deemed permissible for bank holding companies. 39 Fed.

leasing should be a permissible activity for bank holding companies.[3] Another question before the Board was the impact of the Consumer Leasing Act of 1976, particularly the lessee liability section thereof (15 U.S.C. § 1667b(a) (Supp. VI, 1976)), on the Board's personal property leasing rule.

The rule proposed and ultimately adopted by the Board[4] has as its fundamental requirement that the lease "serve as the functional equivalent of an extension of credit". 12 C.F.R. § 225.4(a)(6)(i)(a) (1977).[5] To that end the Board has adopted a "full pay-out" concept of permissible leasing, *i.e.*, the bank holding company lessor's full investment and financing cost is to be recovered from designated sources. These are (a) rentals, (b) estimated tax benefits, (c) residual value,[6] but not

Reg. 11254-55 (1974). NADA petitioned the United States Court of Appeals for the District of Columbia Circuit for review of that order, insofar as it purported to authorize bank holding companies to engage in automobile leasing. Following oral argument before the court of appeals but before decision, the Board sought remand of the case for further administrative action. The court of appeals granted the Board's motion on October 22, 1975.

[3] Subsumed therein is the issue whether automobile leasing meets both of the statutory tests of Section 4(c)(8) of the Bank Holding Company Act, namely, (1) whether automobile leasing is "closely related to banking" (the "closely related test") and (2) whether the performance of this activity by a bank holding company "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects" (the "public benefits" test).

[4] The personal property leasing rule proposed by the Board was the same one it had adopted in 1974 and which had been challenged by NADA. The final rule was virtually identical, the Board having only added a footnote, prohibiting bank holding companies from providing servicing, repair or maintenance or purchasing parts or accessories in connection with automobile leasing activities. 41 Fed. Reg. at 45980, App. A at 17a-18a.

[5] Such a requirement is essential for the activity to be even colorably within the "closely related to banking" standard.

[6] "Residual value", a key element in the typical automobile lease transaction, is the estimate of fair market value of the vehicle at term end which is made by the lessor at the inception of the lease.

to exceed 20% of acquisition cost, and (d) in short-term leases an amount, not to exceed 60% of acquisition cost, as may be attributed to an unconditional guarantee of residual value by a lessee or third party. 12 C.F.R. § 225.4(a)(6)(i)(d).

A. "Closely Related" Issue

Automobile leasing is a singular form of business activity, markedly different from other forms of personal property leasing. Unlike other personal property leasing the automobile lessor is involved in a merchandising role through the regular purchase and sale of automobiles, the assumption of risks not associated with the normal credit transaction and a contract responsibility for involvement in the new- and used-car markets. The principal economic difference is the importance of the residual value factor in the typical automobile lease transaction. Residual value ranges from 20 to 55% of acquisition cost; in other forms of personal property leasing (computers, jet aircraft, etc.),[7] residual value is negligible. Residual value is thus an important component of the automobile leasing business. Accuracy in estimating residual value is an essential business trait. Automobile leasing necessarily involves the lessor in the disposal of used cars on a regular basis.

Automobile leasing is conducted on an "open-end" or "closed-end" basis. In open-end leasing, the lessee or some third party guarantees the residual value, *i.e.*, if the amount actually realized upon sale of the vehicle at term end is less than the residual value, the guarantor (usually the lessee) is responsible to the lessor for the deficiency. In closed-end leasing, there is no guarantee

[7] This type of leasing is sometimes colloquially referred to as "big-ticket" leasing. There, the lessor's investment recovery and profit are derived largely from rentals. At term end, residual value is typically no more than salvage value.

of residual value and the lessor bears the risk of loss with respect thereto.

Automobile leasing is a rapidly-growing business. As found by the Board, automobile leasing to individuals has tripled within the last decade, now accounting for some 10% of the new car market. 41 Fed. Reg. at 45977, App. A at 4a. Total automobile leasing in 1974 represented some 26% of new car production. *Ibid.* Additionally, all projections indicate an expanding role for leasing in the field of automobile merchandising, with some indication that, within the next few years, automobile leases will account for 40% of new car registrations.[8] *Ibid.*

The involvement of financial institutions, including bank holding companies, in automobile leasing is of recent vintage but the growth of these automobile leasing operations has been dramatic. Figures developed by the Board indicate that, in a period of five years, the number of national banks engaged in automobile leasing has more than doubled, with 590 national banks being so involved by 1974.[9] *Id.* at 45978, App. A at 5a. The involvement of bank holding companies, while more recent, has been no less dramatic.[10]

The automobile leasing activities of bank holding companies are conducted either through a "direct" leasing plan or a dealer-network plan, also known as "indirect" leasing. In direct leasing, the bank holding company

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[8] Automobile leases already account for 40% of new car registrations in California, where leasing was first offered on a wide scale. *Id.* at 45,977, App. A at 4a-5a.

[9] While the Board noted the existence of several permissive state banking statutes and regulations, the record indicates that federally-chartered financial institutions constitute the great majority of those involved in automobile leasing. *Id.* at 45978, App. A at 5a.

[10] See *id.* at 45983, App. A at 35a-36a.

lessor deals directly with the lessee, with no dealer intermediary. Under the indirect lease method, the holding company's leasing plan is marketed by automobile dealers who have contracted with the holding company lessor to offer the plan at their business locations.[11]

Under the direct leasing plan, the holding company lessor purchases and delivers the automobile to the lessee at lease inception, and, at term end, the vehicle is returned to the holding company lessor. Under the indirect leasing method, these services are generally performed by the holding company lessor's agent, the participating automobile dealer. In both types of leasing, the holding company lessor is the purchaser-owner of the vehicle and has disposal responsibility at the end of the lease term.[12]

The Board determined that both forms of automobile leasing met the "closely related to banking" test on two principal grounds: (a) that some national banks have recently become engaged in automobile leasing pursuant to a ruling of the Comptroller of the Currency,[13] and (b) that automobile leasing is functionally equivalent to an extension of credit.[14]

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[11] The term "indirect" is a true misnomer. The bank holding company lessor establishes all the substantive terms of the transaction, provides all the necessary contract forms and clearly is the principal in the transaction. The participating dealer is nothing more than an agent of the bank holding company. *Id.* at 45984, App. A at 37a.

[12] Under the Board's rule, the holding company lesson may also re-lease the vehicle. 12 C.F.R. § 225.4(a)(6)(i)(f).

[13] The Board also relied on the involvement of banks in other forms of personal property leasing.

[14] The Board's conclusion that the "functional" test was met was based on its perception that automobile leasing had many similarities to secured lending.

B. "Public Benefits" Issue

While the entry of bank holding companies in the automobile leasing business is recent, the growth and impact of such entry has been dramatic. Aside from the figures evidencing the increase in automobile leasing activities of banks, the administrative record before the Board demonstrated that bank holding companies had assumed a commanding market share in their brief involvement in the automobile leasing business.[15] For example, a bank holding company leasing operation in Washington, affiliated with that state's dominant financial institution, had established a leasing operation of 300 (out of a total of 480) automobile dealers in less than three years of operation. *Id.* at 45983, App. A at 35a-36a. Similarly, a California bank holding company leasing operation, had, as of 1975, $118 million in automobile leases on its books, involving some 17,000 lessees and a 750-dealer network. *Ibid.* While acknowledging that bank holding company leasing operations had become "quite large", the Board concluded that bank holding company entry in the automobile leasing business would not produce anticompetitive results. *Id.* at 45,982, App. A at 29a.

C. The Consumer Leasing Act Issue

Following remand to the Board in the first appeal of this case, Congress enacted the Consumer Leasing Act of 1976. One of the provisions of that Act limits the liability of the consumer lessee [16] with respect to guaran-

[15] There was also evidence that independent lessors had been driven from the San Jose, California market by a bank holding company competitor. *Id.* at 45,982, App. A at 26a.

[16] The Act only covers "consumer leases", which are defined as personal property leases made to a natural person, for a term in excess of four months, for a total contractual obligation not exceeding $25,000, primarily for personal, family or household purposes. 15 U.S.C. § 1667 (Supp. VI, 1976.)

tees of residual value.[17] Lessee liability is limited by the following combination of provisions: (a) the statute requires that the residual value estimate shall be a reasonable approximation of the actual fair market value at term end; (b) it provides that a rebuttable presumption shall arise that the residual value estimate was unreasonable and not in good faith where the residual value estimate exceeds the realized value (actual resale value) by more than three times the average monthly lease payment; (c) it provides that a lessor shall not collect any excess liability (*i.e.*, any amount over the product of three times the average monthly lease payment) from the consumer lessee unless the lessor successfully sues the lessee for such excess liability; (d) it provides that in any such suit, the lessor shall pay the lessee's reasonable attorneys fees, regardless of result. The net effect of the foregoing provisions is to limit a consumer lessee's residual value liability to an amount not to exceed the product of three times the average monthly lease payment.

NADA contended before the Board that the lessee liability limitations of the Consumer Leasing Act were inconsistent with that part of the Board's "full pay-out" formula allowing bank holding company lessors to attribute up to 60% of the acquisition cost of the vehicle to a lessee guarantee. See 12 C.F.R. § 225.4(a)(i)(d)(4). Specifically, NADA contended (a) that with respect to consumer leases, the lessee's guarantee exposure was limited to an amount equal to the product of three times the monthly lease payment and a provision attributing up to 60% of acquisition cost for such a guaranty was illusory, and (b) consumer leases could no longer include an "unconditional" guarantee as required by the Board's regulation. See *ibid.*

[17] In open-end leasing, the lessee guarantees the residual value of the vehicle and bears the risk of loss should the actual realized value be less than the residual value projected.

The Board rejected these contentions holding that, notwithstanding the provisions of the Consumer Leasing Act, "the risk of fluctuation of residual value remains with the lessee . . ." 41 Fed. Reg. at 45,979, App. A at 12a. The Board further held that the Act did not "impose a 'condition' upon a guarantee for purposes of its personal property leasing regulation." [18] *Ibid.*

On appeal, NADA contended that automobile leasing met neither the "closely related" nor the "public benefits" tests of section 4(c)(8) of the Bank Holding Company Act and that the Board's regulation was contrary to, or inconsistent with, the lessee liability limitations of the Consumer Leasing Act. The United States Court of Appeals for the District of Columbia Circuit affirmed without opinion, on February 21, 1978, without discussion or mention of these points.

REASONS FOR GRANTING THE WRIT

I

It has long been a basic precept of federal banking policy that there be a rigid line of demarcation between banking and commerce. Whatever the motivating reason behind this policy, be it to insure the solvency of banking organizations or some other reason,[19] the fact is that the Executive,[20] Congress and the courts have recognized an

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[18] In its decision, the Board did not consider, or at least it did not articulate, the impact on the 60% guarantee factor of that requirement of the Consumer Leasing Act that a lessor pay the lessee's attorney's fees, regardless of result, in a suit to recover excess guarantee liability. See *id.* at 45,978-79, App. A at 10a-12a.

[19] See *Arnold Tours, Inc.* v. *Camp*, 408 F.2d 1147, 1151 (1st Cir. 1969), *vacated and remanded*, 397 U.S. 315 (1970).

[20] A 1969 Presidential message to Congress urged it to adopt legislation to regulate one-bank holding companies citing, as reasons for enactment, the disturbing trend towards erosion of the traditional separation between banking and business and noting that

"accepted public policy which strictly limits banks to banking".[21]

Bank holding companies are the largest and most formidable of banking organizations in that they alone are able to gather together under single ownership and control most of the diverse components of the financial industry.[22] The Bank Holding Company Act, like other federal banking legislation, has, as one of its principal purposes, the limitation of bank holding companies to banking or financial activities. The principal exception to the general prohibition against holding company participation in non-banking activities is Section 4(c)(8) of the Act which permits holding companies to engage in "non-banking" activities which are "closely related to banking". Judicial and administrative interpretation of this section will largely determine the role that bank holding companies, with their unique aggregation of economic power, will play in the Nation's commerce and, concomitantly, the extent to which the traditional demarcation between banking and commerce shall be maintained.

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passage of such legislation was necessary "to protect competition and the separation of economic powers." See H.R. Rep. No. 91-1747, 91st Cong. 2nd Sess. 11-12 (1970).

[21] See *Arnold Tours, Inc.* v. *Camp*, 400 U.S. 45, 56, n. 4 (1970), where the Court referred to the legislative history of the Bank Service Corporation Act. See also *Association of Data Processing Service Organizations, Inc.* v. *Camp*, 397 U.S. 150, 157 (1970).

[22] For example, at the end of 1976, the 1,912 bank holding companies in the nation controlled 3,791 banks with commercial bank deposits ($553.6 billion) representing 66.1% of total bank deposits. Further, the total assets of those companies ($699.9 billion) represented 67.9% of total commercial bank assets. *Annual Statistical Digest, 1972-76*, Federal Reserve Board, table 77B at 314. These figures represent a dramatic increase in bank holding company power since 1971 when holding companies controlled only 2,420 banks whose total deposits ($297 billion) represented 55.3% of total bank deposits and whose assets ($362.3 billion) represented 56.7% of total commercial bank assets. See *Annual Statistical Digest, 1971-75*, Federal Reserve Board, table 89B at 229.

Questions of the proper administration of federal banking laws have on several occasions been considered of sufficient importance to warrant review by this Court. See, *e.g.*, *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971); *Whitney Nat'l Bank* v. *Bank of New Orleans & Trust Co.*, 379 U.S. 411, 414 (1965). The Court has also been called upon to reconcile competing statutory principles embodied in federal banking law and other statutes. See *First Nat'l Bank* v. *Dickinson*, 396 U.S. 122 (1969). While the Court has not yet addressed the issue of what kinds of non-banking activities are permitted to bank holding companies, it has reviewed several cases involving interpretation of the powers of national banks. *See, e.g., Yonkers* v. *Downey*, 309 U.S. 590, 596 (1940); *Texas & P. Ry.* v. *Potorff*, 291 U.S. 245, 253 (1934).

Given the increasingly dominant position of bank holding companies in the banking business,[23] the established public policy against a fusion of banking and commercial activities, it appears self-evident that Section 4(c)(8) determinations necessarily present grave economic and policy issues. The instant decision of the Board, having serious and extensive ramifications, first in the automobile business and second, on the policy issue of maintaining a demarcation between banking and commerce, raises questions of public importance warranting review by the Court.

The Board's decision will have a serious, pervasive impact in the field of automobile merchandising. Auto-

[23] Bank holding companies have already been permitted to enter a number of non-banking activities and the effect has been dramatic. A recent Federal Reserve Bank study shows that bank holding companies now control 34 of the 100 largest mortgage companies, 27 of the largest 86 non-captive finance companies, and 13 of the largest factoring companies. See Talley, "Bank Holding Company Financing", *Conference on Bank Structure and Competition* at 128. (Federal Reserve Bank of Chicago, 1975).

mobile dealers and other small independent lessors must now meet the direct competition of the giants of the financial world, the bank holding companies. By way of concrete example, the local Ford, GM, Chrysler and AMC dealers in Petaluma, California will have to compete with the Petaluma branch of Wells Fargo, a bank holding company engaged in automobile leasing and a participant in the rulemaking proceedings.[24] The same scenario will be repeated nationwide.

The growth of automobile leasing in the field of automobile merchandising provides still another reason for review by the Court. The record shows that automobile leasing has experienced a substantial growth in the last fifteen years, with some indicators projecting a 40% market share for automobile lessors within the next several years. The extent, if any, to which bank holding companies are to be permitted to engage in automobile leasing will substantially affect the competitive scheme of that industry and its make-up. The aggressiveness of bank holding companies in this area is documented and there is every indication that full-scale entry, as sanctioned by the Board, may well result in dominance of the industry by bank holding companies. The question of the lawfulness of that activity is one that should be addressed by the Court.

II

The dispositive question presented by this case is whether automobile leasing can properly be considered an activity "closely related to banking" and thus, one open to bank holding companies under Section 4(c)(8) of the Bank Holding Company Act. Such a determination must rest, of necessity, on an operational analysis of the automobile leasing activity.

[24] Wells Fargo Bank, N.A. is the eleventh largest bank in the United States, with total assets of some $13 billion and bank branches in some 200 California municipalities.

The record before the Board demonstrated that automobile leasing was different from other forms of personal property leasing, principally because of the role of the residual value factor in the automobile leasing transaction and the involvement, on a regular basis, in the purchase and sale of automobiles. Depending on the lease terms and other factors, residual value will constitute between 20 to 55% of the lessor's investment.[25] The very size of the residual value factor causes it and the estimate thereof made by the lessor to be a central feature in the lease transaction. Unlike other forms of personal property leasing, the automobile lessor engages in a merchandising, as opposed to financial, activity.

Similarly, the automobile lessor is directly and substantially involved in the purchase, sale and other disposal of automobiles. In direct leasing operations, the automobile lessor actually purchases the vehicle.[26] The disposal responsibility is also a unique feature of automobile leasing.[27] In fact, it is of paramount importance since residual value and actual realization thereof constitute a major part of the leasing operation. This economic fact of life results in the "preordained participation [of bank holding companies] in the market disposition of personal property . . . ." [28]

The Board was faced with a business activity which was substantially different from other forms of personal

[25] In other forms of personal property leasing, residual value is a negligible factor.

[26] The lessor is only slightly less involved in "indirect" leasing, since it is clearly the principal in the transaction and the participating dealer its agent.

[27] In "big-ticket" leasing, the disposal role is perfunctory since the lessor has recovered its investment, and, typically, the leased property is of salvage value only.

[28] *M & M Leasing Corp.* v. *Seattle First Nat'l Bank*, 563 F.2d 1377, 1385 (9th Cir. 1977), *petition for cert. filed*, 46 U.S.L.W. 3602 (U.S. March 20, 1978) (No. 77-1325) (dissenting opinion).

property leasing, one in which the lessor was involved, by the very nature of the transaction, in the purchase, sale or re-leasing of new and used vehicles, one in which the basic business skill or expertise is that of an automobile merchandiser rather than a financier.

Unlike secured loans, to which the Board anologized automobile leasing, the latter activity contemplates, as a matter of contract obligation, the return of the vehicle to the lessor for disposal.[29] Because of this obligation, the holding company lessor "is thus drawn ineluctably into the business of disposing of used chattels. . . ." [30]

The Board has concluded that this is a proper activity for bank holding companies; indeed, it has sanctioned even more, by permitting bank holding companies to release vehicles on an indefinite basis. The Board's action is at substantial variance with the established federal policy of restricting financial institutions, including bank holding companies, to bank-related activities,[31] so much so that it requires remedial action by this Court.[32]

[29] In secured lending, "repayment rather than repossession is the bank's primary objective." *Alabama Ass'n of Ins. Agents, Inc.* v. *Board of Governors of Federal Reserve System*, 533 F.2d 224, 245 (5th Cir. 1976), *cert. denied*, 46 U.S.L.W. 3541 (U.S. February 27, 1978) (No. 77-668).

[30] *M & M Leasing Corp.* v. *Seattle First Nat'l Bank*, 563 F.2d at 1385 (dissenting opinion).

[31] The permissiveness of the Board's leasing rule will allow bank holding companies to also lease office furniture and the like. It is inconceivable that Congress intended that bank holding companies be allowed to become giant leasing companies under the "closely related to banking" standard.

[32] The Board's decision also conflicts in principle with the holding of the court of appeals in *M & M Leasing Corp.* The Board has permitted bank holding companies to attribute up to 20% of acquisition cost to residual value. See 12 C.F.R. § 225.4(a)(i)(6)(d)(3). The *M & M Leasing Corp.* court held that only leases in which the residual value "contributes insubstantially" to investment recovery were permissible. 563 F.2d at 1384.

III

The Board's rule also permits bank holding company lessors to attribute up to 60% for a lessee's guarantee of residual value for purposes of meeting its "full payout" concept of permissible leasing. 12 C.F.R. § 225.4(a)(6)(i)(d)(4). The Board rejected the contention that the Consumer Leasing Act of 1976 had any impact on this 60% guarantee factor.[33] One of the principal purposes of that Act is to limit the guarantee liability of a consumer lessee and it does so by effectively limiting the lessee's liability to an amount not to exceed the product of three times the monthly lease payment. 15 U.S.C. § 1667b(a). The Board's 60% guarantee factor is wholly inconsistent with the statutory limitation. There can no longer be a fully "open-end" consumer lease. The effect of the Act is to create a hybrid form of lease, one which is neither fully "open-end" nor "closed-end". That Act substantially shifts the risk of loss for fluctuations in residual value to the lessor. The Board was called upon to modify its personal property leasing rule to account for these changes.[34] Its failure to do so unlawfully expands the area of permissible non-banking activity for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act, for the reason that a leasing activity in which the lessor is speculating on realization

[33] While the Board made no finding as to the amount of leasing which would be covered by the Consumer Leasing Act, it did find a very substantial increase in the leasing of automobiles to individuals, namely, a tripling thereof within the last decade, now accounting for a 10% market share. It can safely be assumed that a substantial portion of automobile leasing to individuals would be covered by the Act.

[34] Specifically, the rule should have been amended to provide that, with respect to consumer leases, the amount that could be attributed to a lessee guarantee would be limited to the product of three times the montly rental.

of residual value can in no wise be viewed as the "functional equivalent of an extension of credit." [35]

IV

There is presently pending before the Court a petition for certiorari in a case styled *M & M Leasing Corp.* v. *Seattle First National Bank, et al.*, No. 77-1325, filed March 20, 1978. The principal issue raised by that case is whether national banks are authorized, under the incidental and necessary powers clause of the National Bank Act, to engage in automobile leasing activities, or, put otherwise, whether automobile leasing is part of the "business of banking". The basic issue in this case is whether automobile leasing is "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act and thus, a permissible activity for bank holding companies.

The Court has before it in these cases the common issue of whether automobile leasing, as conducted today, is a banking or financial activity, one permitted to federally-chartered financial institutions. The incidental powers clause of the National Bank Act and the permissible non-banking activities of bank holding companies both have as their reference point the business of banking. Granted that there is a difference between the two statutory standards, nonetheless a determination of what constitutes the "business of banking" is the core issue.

The instant case also presents another related statutory issue, namely, whether the Consumer Leasing Act, particularly the limitation of lessee liability provided therein, has so changed the respective liabilities of the parties to

[35] A holding company lessor is entitled, under the rule, to attribute up to 60% of acquisition cost to a lessee guarantee for "full payout" purposes. In a consumer lease situation, the holding company lessor will be speculating that any residual value deficiency will not exceed the product of three times the monthly rental.

a consumer lease and the underlying lease transaction that, by definition, a consumer lease cannot be viewed as a banking or financial transaction, thus making it impermissible for national banks and bank holding companies alike.[36]

These cases afford the Court a unique opportunity to resolve the basic question of whether automobile leasing is part of the business of banking and, thus, appropriate for federally-chartered financial institutions and the related question of whether the Consumer Leasing Act has altered the fundamental nature of the automobile leasing business. Both of these questions warrant review.

CONCLUSION

For the foregoing reasons, the writ should issue.

Respectfully submitted,

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[36] This issue is not presented in the *M & M Leasing Corp.* petition since that case was litigated prior to enactment of the Consumer Leasing Act.

Appendices

APPENDIX A

Order of the Board

FEDERAL RESERVE SYSTEM

[12 CFR Part 225]

[Regulation Y]

BANK HOLDING COMPANIES

Nonbanking Activities of Bank Holding Companies

[Docket No. R-0009]

Effective April 17, 1974, the Board of Governors amended section 225.4(a)(6) of its Regulation Y, 12 CFR 225.4(a)(6), to permit bank holding companies to engage in the leasing of real and personal property subject to certain conditions. The National Automobile Dealers Association ("NADA") sought judicial review of this leasing regulation insofar as it permitted bank holding companies to engage in the leasing of automobiles. The Board requested the court to remand the matter to the Board for reconsideration of the specific issue of whether automobile leasing should continue to be a permissible activity for bank holding companies. On October 25, 1975, the court granted the Board's request and remanded the matter to the Board.

On November 11, 1975, the Board issued notice (published in the *Federal Register* on November 17, 1975, 40 *Federal Register* 53272), of a proposed rulemaking on whether automobile leasing should continue to be a permissible activity for bank holding companies and, if so, under what conditions or limitations. The Board received

written comments from approximately 100 interested parties, including automobile dealers, automobile leasing companies, banks, bank holding companies, and various trade associations. In response to several requests for an opportunity to present views orally and for a formal hearing, the Board announced on January 20, 1976 (published in the *Federal Register* on January 28, 1976, 41 *Federal Register* 4022), a schedule for oral presentation of views and additional written submissions. On March 23, 1976, the informal hearing was held before available members of the Board, Governor Jackson presiding. Participants were permitted to file additional materials until April 23, 1976.

The Board has considered all comments received prior to the oral presentation, the record of the oral presentation, and all written statements submitted in connection with and subsequent to the oral presentation. Although bank holding companies have been permitted to engage in automobile leasing since 1974 under the Board's general personal property leasing regulation, section 225.4 (a)(6)(*a*) of Regulation Y, the Board has considered the issue of the permissibility of automobile leasing on a *de novo* basis and has based its findings only upon the record of this proceeding.[1] After studying the record herein, the Board has determined that automobile leasing should continue to be a permissible activity for bank holding companies and should continue to be included within the scope of the Board's existing personal property leasing regulation.

[1] The Board has considered all submissions of the parties to this proceeding. It has considered all suggestions for changes in the Board's existing personal property leasing regulation as applied to the lease of automobiles. In this Order, the Board has summarized and dealt specifically with the major arguments and suggestions of all parties in adopting a regulation permitting bank holding companies to continue to engage in automobile leasing. To the extent that any arguments and suggestions opposing the regulation are not treated individually in this Order, they have been considered and dismissed as without merit.

In order to authorize a bank holding company to engage in a nonbanking activity pursuant to section 4(c)(8) of the Bank Holding Company Act ("Act"), the Board must first determine whether the activity is closely related to banking or managing or controlling banks. Such a determination is usually made by the Board, as here, by regulation in adding the proposed activity to the list of permissible activities set forth in Regulation Y. The second determination required by the statute is that the activity is a "proper incident" to banking. That is, that performance of the activity by a bank holding company "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects. . . ." As set forth below, in adopting and determining in this action to retain the regulation the Board has made a general finding that the activity is a proper incident to banking. However, as provided for in the Board's regulations and procedures, in many cases, this issue is reconsidered in light of factors peculiar to individual applications at the time such applications are submitted.

I. The Closely Related to Banking Test

There are a number of tests that the Board applies to proposed new activities and, if an activity qualifies under any one of these, it may be determined to be closely related to banking and added to the list of activities in Regulation Y that are permissible for bank holding companies if also found to be a proper incident. It appears on the basis of the record that automobile leasing qualifies under at least two of these tests.

The first of these tests is a strictly factual test of whether banks generally have provided and do provide the proposed service.[2] Although automobile leasing is a

[2] See the Board's Order of November 15, 1973, adding courier activities to the list of activities in the Board's Reg. Y that are permissible for bank holding companies. 1973 Federal Reserve

relatively new activity, banks engage in the activity on a widespread basis. Moreover, banks have been engaged in leasing of other types of personal property for a much greater period of time,[3] and the Board considers these legitimate precedents for automobile leasing since it does not appear that the basic nature of the activity is altered by the type of item leased.

The relevant period consider bank involvement in automobile leasing is the last 25 years, since it is only within that period that leasing of vehicles to individuals as well as to businesses began to develop. Banks began to engage in automobile leasing at a relatively early stage of the industry's development even though the actual length of time that banks have been involved in automobile leasing has not been great.

Automobile leasing has spread nationwide within the last 12 to 15 years. Leasing of automobiles to individuals has tripled within the last decade and accounts for 10 per cent of the new car market nationwide.[4] Total automobile leasing including commercial fleet leasing in 1974 was 2.8 million vehicles, about 26 per cent of new car production.[5] Some projections indicate that this rate of growth will continue and that by 1980, 40 per cent of new car registrations will be for leased automobiles.[6] In

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Bulletin 892. See also *National Courier Association* v. *Board of Governors*, 516 F.2d 1229, 1237 (D.C. Cir. 1975).

[3] Testimony of Professor Bower: Letter, dated March 12, 1976, pp. 5-8 and Transcript (hereinafter abbreviated Tr.), pp. 154-56; California Bankers Assoc. (hereinafter "CBA"), March 12, 1976, p. 7.

[4] Tr., p. 68; 1975 Federal Reserve Bulletin 414.

[5] Federal Reserve Bank of Chicago December 22, 1976, p. 2, citing 1975 Federal Reserve Bulletin 414.

[6] Tr., p. 68; Trust Company of Georgia, March 4, 1976, and United States National Bank of Oregon, December 22, 1975.

California, where leasing first developed, two out of every five automobiles presently in use are leased.[7]

The record in this proceeding indicates that five types of entities compete in the leasing industry today. First, there is the independent leasing organization which engages solely in leasing rather than selling automobiles. The second type of entity is the auto dealership which, in addition to selling automobiles, has the potential to lease vehicles if it can obtain adequate financing. The larger dealerships lease vehicles in much the same way as independent leasing companies, frequently obtaining financing from a bank. The third type of lessor is the bank holding company that may lease vehicles directly or through a network of smaller automobile dealerships. The fourth kind of leasing competitor is the financing affiliate of the auto manufacturer such as Ford Motor Credit Corporation and General Motors Acceptance Corporation. These organizations use their own network of auto dealers to conduct their leasing operations. Finally, certain large retail corporations have entered or may enter the market. Most notably, Sears, Roebuck and Company, the nation's largest retail corporation, has begun to expand its automobile leasing operation nationwide.

National banks have been engaged in automobile leasing since the 1963 ruling of the Comptroller of the Currency that such activity was properly incidental to banking. In addition, 31 States have specific statutes permitting banks to lease personal property, and in other States the bank supervisory authority permits State banks by regulation to engage in the activity.[8] In 1968 there were 267 national banks engaged in auto leasing; by 1974 the number rose to 590 national banks. Another survey, that included State banks, showed 680 banks engaged in auto-

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[7] CBA, March 12, 1976, p. 1.

[8] Tr., p. 66.

mobile leasing in the early 1970's, with lease outstandings of $400 million.[9] It appears that the number of banks involved in automobile leasing is continuing to grow.

On the basis of (1) the historical involvement of banks in the leasing of personal property such as railroad stock and ships, (2) the large and growing number of banks that lease automobiles, (3) the fact that banks entered the automobile leasing industry at an early stage and are now a significant component of the industry, (4) the fact that the Comptroller of the Currency and over two-thirds of the States have determined that automobile leasing is a permissible activity for banks, and (5) the likelihood that the number of banks engaging in automobile leasing will continue to grow, the Board concludes that automobile leasing is closely related to banking.

The second test pursuant to which the Board finds automobile leasing to be closely related to banking is a functional test, i.e., whether banks generally provide services that are functionally or operationally similar to the proposed service and are thus qualified to provide the proposed service. The parties to this proceeding argued strenuously about whether automobile leasing is functionally equivalent to other banking services.

Those parties to the proceeding in favor of the performance of the activity by bank holding companies (generally hereafter "proponents") argued that leasing is essentially a financial transaction since it is an alternate method of financing the purchase of an automobile without the necessity of a large initial down payment. Thus, to the customer it is a means of obtaining the possession and use of an automobile through deferred payment. To the bank it is another in a spectrum of methods of new car financing that includes instalment credit transactions,

[9] Fulton Bank, Lancaster, Pennsylvania, December 2, 1975, and Boatman's Bank, St. Louis, Missouri, December 19, 1975.

floor planning and commercial lending to independent lessors.[10]

Those parties to the proceeding opposed to the performance of the activity by bank holding companies (generally hereafter "opponents") argued that automobile leasing is essentially a merchandising activity in which reliance on the residual or resale value of the leased vehicle upon the completion of the lease term is the critical element. They argue that the need for the lessor to estimate and thus to speculate on the resale value of a new automobile three years hence makes automobile leasing different from an extension of credit or other types of personal property leasing.[11]

On the basis of the record, the Board has concluded that automobile leasing, if conducted by a bank holding company in accordance with the Board's existing personal property regulation, is essentially a financial transaction that is functionally equivalent to a bank's lending function. The leases written by a bank holding company in the lease of an automobile have many similarities to a secured loan. In each case there is a sum certain in amount. This sum includes the acquisition cost of the vehicle and the cost of financing and is recovered through a schedule of noncancellable deferred payments. The term of the payment period in both cases is 24 to 36, or recently to 48 months. The vehicle serves as a type of collateral to guarantee payment on both the instalment loan and the lease. Both forms of financing are applied to a specific automobile that is chosen prior to preparation of the document. In the case of a lease the bank is required by the Board's Regulation Y, section 225.4(a)

[10] See, for example, Tr., pp. 6, 8-9, 156-159, 182, 184; CBA, March 12, 1976, pp. 8-11.

[11] See, for example, Tr., pp. 39, 42, 110-119, 220; NADA, December 22, 1975, pp. 9-19, Southwest Leasing Corp. ("SW"), December 15, 1975, pp. 3-4.

(6) (*a*)(*ii*), to acquire the automobile specifically for an individual transaction. All attributes of ownership pass to the lessee who is responsible for servicing, insurance, and depreciation.

In addition to the above, the proponents have testified that they use the same skills in leasing a vehicle as they do in financing it through an instalment loan.[12] They assess the credit-worthiness of the lessee, examining his record on repayment of earlier obligations and reviewing his ability to meet the payment schedule. They examine the collateral involved to determine its value over the term of the lease. In fact, since the amount financed is larger in the case of a lease than in the case of a loan, the credit criteria are usually a little more stringent.

The opponents argue, however, that the Board's regulation which allows reliance by a lessor upon a residual value of 20 per cent in computing a full-payout recovery permits speculation in property and alters the character of the transaction from that of a loan.[13] They point out that a lender does not generally have an equity interest in the property being financed.[14] Further, the Federal District Court for the Western District of Washington determined in *M&M Leasing Corporation* v. *Seattle-First National Bank* [15] that any lease in which the bank bears any risk of loss is not the equivalent of a loan.

The record of the proceeding reflects that the resale value of automobiles at the conclusion of a two- to three-year lease is generally between 20 and 55 per cent of a vehicle's acquisition cost.[16] By setting a maximum resi-

[12] Tr., pp. 8-9, 77-78; Seilon, Inc., Toledo, Ohio, December 16, 1975.

[13] Tr., pp. 104-106.

[14] Tr., pp. 40, 117-118.

[15] 391 F. Supp. 1290 (W.D. Wash. 1975).

[16] Tr., pp. 19, 90, 104, 106, 126.

dual value of 20 per cent, the Board is recognizing that, on an empirical basis, automobiles have a useful life in excess of the lease term. On the other hand, the figure is a small enough percentage of the original price of the automobile to ensure that the holding company will be truly financing a lessee's acquisition and use of a vehicle rather than conducting a short-term rent-a-car operation. The record in this proceeding reflects that in 90 to 98 per cent of leases the vehicle is worth more than the residual value at the conclusion of the lease and is therefore purchased by the lessee,[17] and, even with respect to those vehicles returned at the end of the lease there is frequently no deficiency.[18] Thus, the Board finds that the risk of loss in a lease transaction cannot be said to be significantly greater than in a loan transaction and a bank holding company lessor cannot be said to be speculating in the value of property.

While, as indicated above, a lease in which the lessor relies on a residual value of up to 20 per cent of the initial value of the property to calculate payments that provide for a "full payout" is equivalent to and a substitute for an extension of credit, the record in the proceeding reflects that banks and bank holding companies presently engaging in leasing activities uniformly write open-end leases in which the lessee guarantees the estimated residual value. If upon resale at the end of the lease term, the vehicle does not bring the estimated residual value, the lessee agrees to reimburse the lessor for the deficiency. If the vehicle's actual resale price exceeds the estimate, the lessee receives the surplus.

Th Board's existing personal property leasing regulation, section 225.4(a)(6)(*a*)(*iv*)(*4*) of Regulation Y, permits the lessor bank holding company to rely upon

[17] Tr., pp. 11, 45, 56-58, 62, 72, 89, 95, 165, 176, 180.

[18] Tr., pp. 11, 176, 180.

residual value up to 60 per cent of the acquisition cost of the vehicle if the residual value is unconditionally guaranteed by a financially qualified third party. This 60 per cent figure corresponds to the maximum residual value for most vehicles after a two- or three-year lease,[19] and the Board believes such a ceiling prevents speculation on residual value and preserves the lease as the functional equivalent of an extension of credit. The court in *M&M Leasing*[20] found this traditional automobile lease with the guarantee of residual value to be the functional equivalent of a loan.

Subsequent to the Board's adoption of the guarantee provisions, on March 23, 1976, Congress enacted the Consumer Leasing Act[21] which provides, in part, that with respect to a guarantee of residual value a lessee is obligated to pay the difference between the projected residual value and the actual resale price only if the estimate of the residual value is reasonable and made in good faith. The estimate is presumed unreasonable if it exceeds the actual resale value by more than three times the lessee's average monthly rental payments. Except in the case of unreasonable wear and use or a mutually agreeable final adjustment, the lessor can recover an additional sum only by filing suit and by demonstrating to a court that the estimate of residual value was reasonable and made in good faith.

The opponents argue that the Consumer Leasing Act effectively prevents reliance by bank holding company lessors upon the lessee guarantees of residual value. In their view, such a guarantee is no longer unconditional as required by the Board's regulation, as the lessor is compelled to rely upon the resale value of the vehicle rather

[19] See note 16.

[20] See note 15.

[21] 90 Stat. 257, codified as 15 U.S.C. 1667 (1976).

than the credit-worthiness of the lessee. This, they argue, destroys the equivalency of the lease to a loan.[22]

Initially, it is clear from the legislative history of the Consumer Leasing Act that Congress intended this legislation to protect the consumer from liability for unreasonable balloon payments at the end of a lease term. The legislation was not intended to indirectly prohibit banks and bank holding holding companies from engaging in automobile leasing by eliminating any possibility that they could rely upon a lessee guarantee.[23] In fact, the legislation was specifically designed to ensure that the "estimated residual value shall be a reasonable approximation of the fair market value of the property on lease expiration." Reasonableness in the estimating of residual value is required by the Board's regulation and is one reason for imposing a 60 per cent ceiling on the guarantee provision. If the guarantee is reasonable then there is no ban on reliance upon it under the Consumer Leasing Act. The Report of the Senate Committee on Banking, Housing and Urban Affairs, in reporting out the version of section 183 of the Consumer Leasing Act that ultimately was enacted, recognized that the lessee bears the risk of loss upon which lessors may rely.

> The lessor's obligation under this language (of section 183) is to make a good faith and rational estimate of future residual value based on circumstances and information available at the time the lease was written. If the lessor does so the lessee bears the risk of unanticipated fluctuations in market value and the lessor is assured of full recovery under the lease.[23a]

[22] NADA, April 23, 1976, pp. 9-13, and American Imported Automobile Dealers Assn., April 22, 1976, and SW, April 13, 1976.

[23] House Report, No. 544, 94th Cong., 1st Sess., 1975; 121 Cong. Record, H10308-10312.

[23a] S. Rep. No. 590, 94th Cong., 2d Sess., 1973.

The Board belives that, even in light of the Consumer Leasing Act, an automobile lease wherein the bank holding company lessor relies upon a reasonably estimated residual value guaranteed by the lessee remains functionally equivalent to a loan. If anything, the Consumer Leasing Act eliminates possible speculation on residual values and forces the lessor to adopt very conservative residual values. The bank holding company looks to the lessee for rental payments and in the event of default, particularly in the early stages of a lease when most defaults occur [24] and when resale value of the automobile does not equal the lessor's costs. The lessor also relies upon the lessee for reimbursement in the event of deficiencies between estimated and actual resale value, particularly when such deficiencies are less than three monthly rental payments.[25] It stands to reason that, as in the case of a loan, a bank holding company lessor would prefer to rely upon payment by a lessee/debtor rather than to attempt to dispose of the leased item/collateral.

The risk of fluctuation of residual value remains with the lessee, and even the small risk borne by the bank holding company that a court may find the estimate of residual value unreasonable is no greater than the risk always present in making a secured loan. As in the case of reliance upon an unguaranteed residual value of 20 per cent or less, a minimal risk of loss does not destroy the lease's equivalency to an extention of credit.

Furthermore, the Board does not consider the Consumer Leasing Act to impose a "condition" upon a guarantee for purposes of its personal property leasing regulation.

[24] Tr., p. 31.

[25] The Board believes in light of the "safety factors" used by banks and bank holding companies in estimating residual values, it is likely that any deficiency will be less than the average of three monthly rental payments. See Tr., pp. 9, 72, 166.

The need to follow certain statutory procedures to enforce the provisions of a document such as a lease or a secured loan does not necessarily "condition" that document. Nor does the need to prove that the estimate of residual value is reasonable impose a condition upon recovery within the contemplation of the regulation. The Board has required the estimate of residual value to be reasonable upon the signing of the lease. All conditions to recover upon the lease have been fulfilled at that time and the document is subject to enforcement.

An additional argument that the opponents raise to establish that leasing of automobiles is not functionally equivalent to financing is that it more closely resembles the merchandising of used cars since the bank holding company lessor must estimate the vehicle's residual value, must purchase the vehicle and must dispose of it upon completion of the lease term. They argue that the need to estimate, and to rely upon, the residual value of the vehicles leased transforms the leasing of automobiles into something more than a financial transaction, particularly since automobile leasing is the only type of personal property leasing that relies to such a significant degree upon the factor of residual value.[26]

These possible aspects of the activity have been of concern to the Board and it has imposed certain conditions designed to avoid any merchandising aspects of leasing and to preserve its financial character. The regulation requires that the bank holding company acquire the item to be leased specifically for the transaction under consideration (section 225.4(a)(6)(*a*)(*ii*)) and that at the end of the lease term the holding company release the item or dispose of it within two years (section 225.4(a)(6)(*a*)(*vi*)). Both of these provisions are designed to prevent the stockpiling or inventorying of property, ac-

[26] Tr., pp. 41, 104-105, 111-113, 117-119, NADA, December 22, 1975.

tivities that indicate a commercial or merchandising operation. The bank holding company may purchase an automobile only as already selected by an individual lessee and must dispose of that vehicle promptly, if it is returned rather than purchased or otherwise disposed of by the lessee.

In the case of indirect leasing, the prospective lessee deals with an automobile dealer rather than a bank or bank holding company directly. The bank or holding company merely purchases the vehicle selected from the dealer after the dealer and lessee have agreed upon the make and model, the accessories to be included and the date of delivery. The lessor's role is the traditional banking function of credit analysis and approval of the written financing agreement. Since the dealer is responsible for delivery, the vehicle may never even be seen by the lessor.[27]

The bank holding companies and banks do prepare a schedule of leasing fees for dealers in their network, and this includes a projection of residual values. The proponents testified that they project residuals on the basis of the Kelly Blue Book of wholesale prices and similar auto industry projections, conservatively tempered by a safety factor and without any reliance upon the inflation that has marked the used car market in recent years.[28]

The projection of residual value draws upon the same knowledge and expertise with regard to the value of collateral that banks rely upon when making secured loans. Banks have traditionally appraised property before accepting it as collateral for a mortgage loan, refusing the loan if the purchase price exceeds the bank's estimated resale value of the property. On various types

[27] Tr., pp. 8-10, 71-72, Seilon, Inc., *supra*, and First Hawaii Bank, December 17, 1975.

[28] Tr., pp. 9, 71, 166, 175, 180.

of secured loans banks have traditionally required down payments that are a certain percentage of the purchase price of the item financed as protection in the event of early default and repossession. These banking functions require a level of competence in assessing the value of collateral. The estimate of residual values in automobile leasing is considered by the Board to be equivalent to existing banking functions.

In the case of direct leasing the bank or holding company is more involved than in the case of indirect leasing since it deals directly with the lessee, and thus greater concerns are raised as to "merchandising." However, the banks and bank holding companies have testified that they do not counsel or advise the prospective lessee as to the make or model of vehicle he may wish to lease, or even suggest that he lease rather than buy.[29] They may merely put the lessee in contact with a dealer who is conveniently located to provide servicing and maintenance.[30] Frequently, as in the case of indirect leasing, the holding company never even has possession or control of the vehicle which is delivered from dealer to lessee.

As an additional safeguard to prevent bank holding company lessors from becoming too involved in the commercial aspects of automobile leasing, the Board's regulation (section 225.4 (a)(6)(*a*)(*iii*)) requires the leases be written on a nonoperating basis. This means that the bank holding company may not provide for servicing and maintenance of the vehicle or for similar functions. The bank holding company administers the lease as it would administer a loan.

The opposing parties additionally charge that disposal of the vehicle at the end of the lease forces the holding company into the merchandising of used cars. The experi-

[29] Tr., pp. 10, 77, CBA, March 12, 1976.

[30] Tr., p. 96.

ence of banks and bank holding companies, however, demonstrates that this activity is very limited because only a small percentage of the vehicles are returned to the lessors. In addition to the earlier cited testimony that between 90 and 98 per cent of all vehicles leased by banks are disposed of by the lessee, both Alameda Bancorporation and Wells Fargo Bank testified that only 2 per cent of their leased vehicles were returned for resale.[31] First National Bank of San Jose has had to dispose of fewer than 5 per cent of its leased vehicles,[32] and Seattle-First National Bank has had to dispose of only two vehicles wholesale out of a total of 345 normally terminated leases since April, 1973.[33]

Such figures tend to demonstrate empirically that the banks are not engaged in the merchandising of used automobiles but are merely incidentally disposing of a few vehicles as they would in the case of repossession on a secured auto loan. Indeed, Seattle-First testified that it repossessed 147 vehicles during the same period that it disposed of two leased vehicles.[34] Wells Fargo "repossessed" approximately 370 leased vehicles in 1975 (out of a total of 17,000) for failure to make payments, but only 30 additional automobiles were returned at the close of the lease period.[35] Even if the number of leased vehicles returned to the bank lessors was significantly greater, the disposal of such vehicles wholesale, or through auction on the same basis as repossessed vehicles in the case of a secured loan, is merely a necessary incident to automobile leasing. It is conducted in a routine manner and does not involve bank holding companies in merchandising to any significant degree.

[31] Tr., pp. 165, 176.

[32] Tr., pp. 72.

[33] Tr., p. 11.

[34] Tr., p. 11

[35] Letter from Wells Fargo Bank, p. 13, March 12, 1976

One opposing party has presented a series of brochures advertising the leasing activities of some banks and a very small number of bank holding companies in an attempt to show that banks themselves view automobile leasing in terms of merchandising automobiles rather than financing or extending credit. This literature emphasized such services as locating the vehicle of the customer's choice, purchasing it on favorable terms, delivering it without cost and disposing of it at the conclusion of the lease term.

Such advertising is likely to be used only in the case of direct leasing, according to testimony by the proponents, since in the case of indirect leasing these services are performed by the auto dealer with whom the prospective lessee negotiates.[36] If the advertising is prepared by the bank holding company for use by all of the dealers in its network and merely demonstrates the dealers' services as opposed to those of the holding company, the Board belives no issue as to merchandising by the holding company is raised.

When such advertising emphasizes certain incidental leasing services of the bank holding company itself, however, such advertising still does not alter the basic nature of the lease transaction. It appears customary to obtain lending or leasing business by emphasizing the automobile such a loan or lease will secure. The Board also notes that the Consumer Leasing Act has an express provision regulating the advertising of leases,[37] and that this will provide the necessary safeguards against deceptive advertising.

However, in order to insure that leasing of automobiles by bank holding companies remains essentially a financing transaction and does not take on the character of

[36] Tr., p. 76.

[37] Section 184, 90 Stat. 259, 15 U.S.C. 1667(c) (1976).

merchandising, the Board believes it appropriate to define more fully the requirement of the existing regulation that bank holding company leasing be conducted on a nonoperating basis. Accordingly, the Board is amending its personal property leasing regulation by adding the following footnote.

> For purposes of the leasing of automobiles, the requirement that the lease be on a nonoperating basis means that the bank holding company may not, directly or indirectly, provide for the servicing, repair or maintenance of the leased vehicle during the lease term; purchase parts and accessories in bulk or for an individual vehicle after the lessee has taken delivery of the vehicle; provide for the loan of an automobile during servicing of the leased vehicle; purchase insurance for the lessee; or provide for the renewal of the vehicle's license merely as a service to the lessee where the lessee could renew the license without authorization from the lessor.

With this additional safeguard and the other limitations on the automobile leasing activities of bank holding companies already contained in the regulation, the Board concludes that the essence of automobile leasing will remain the financing of the use and control of a vehicle by a lessee. It is the equivalent of a loan and thus meets a second of the tests for establishing that an activity is closely related to banking.

II. The Proper Incident to Banking Test

The determination that automobile leasing by bank holding companies is "closely related to banking or managing or controlling banks" resolves the first portion of the two-part test of section 4(c)(8). Resolution of the second issue, whether bank holding company automobile leasing "can reasonably be expected to produce benefits

to the public . . . that outweigh possible adverse effects," is usually achieved through the consideration of the individual applications of bank holding companies to engage in automobile leasing. This is the case since the public benefits or adverse effects may vary considerably with each application depending on such factors as the size and condition of the applicant and the competitiveness of the relevant market. Nevertheless, before placing a nonbanking activity on the list of activities that have been found to be "closely related to banking or managing or controlling banks," the Board finds it desirable to make a generalized examination of the activity and to determine, as a general matter, whether the balance of reasonably expected public benefits and possible adverse effects is such that it would be in the public interest for bank holding companies to enter the industry in question. Particularly in the case of uncontested applications to engage *de novo* in the proposed activity, the public benefits findings made during the rulemaking proceeding may prove helpful or perhaps dispositive.

With respect to the question whether bank holding company performance of leasing activities may lead to possible unfair competition, opponents contend that independent lessors are unable to compete with either the direct or indirect leasing programs of bank holding companies because of significant differentials in the cost of funds. Since banks are the source of funds for the independent lessors, the opposing parties claim that bank holding companies can and do require the independent lessors to pay interest rates that make it impossible for them to be competitive with bank-affiliated dealers and leasing subsidiaries.[38] They allege that in some instances leasing subsidiaries of bank holding companies may borrow funds from their parent corporations without inter-

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[38] Tr., p. 48; SW December 15, 1975, p. 8.

est.[39] Further, they contend that the financial resources of holding companies allow them to set the residual value on leased vehicles artificially high, thereby creating smaller monthly payments coupled with a large balloon payment at the end of the lease term. Independents are unable to match these lower monthly payments because it would mean a negative cash flow.[40]

The proponents contend that holding companies generally borrow funds at approximately the same rates as the independent lessors.[41] They state further that section 23A of the Federal Reserve Act effectively prohibits holding companies from borrowing from their banking subsidiaries and that holding companies must borrow their funds from other banks. They thus contend that leasing subsidiaries of holding companies are, therefore, in the same position as independent lessors *vis-a-vis* access to funds.[42] Moreover, if one bank were to set the price of funds for independent lessors artificially high, other banks would find it profitable to offer funds at a lower rate and thereby acquire new customers.[43] Almost all of the banking parties testified that, although involved in auto leasing, they continue to provide funds to independent lessors, and that there is an adequate number of banks competing to provide such financing.[44]

The Board finds that large independent lessors have approximately the same cost for borrowed funds as holding companies. It appears that the disparity between the cost of borrowed funds for holding companies and

[39] SW, April 21, 1976, p. 1.

[40] Tr., p. 58.

[41] Tr., pp. 169, 190.

[42] Tr., pp. 169, 180-81.

[43] Tr., p. 53.

[44] Tr., pp. 201-202.

small independent lessors is based primarily on the relative size of holding companies rather than advantages gained from affiliation with the banking subsidiaries. Indeed, large independent lessors appear to have a similar advantage over small independent lessors with regard to the cost of borrowed funds. Further, the record demonstrates that holding companies obtain at least a portion of their funds by borrowing from unaffiliated banks.[45] It is the Board's judgment that access to the securities market or a lower cost of borrowed funds resulting from the size of holding companies does not represent an unfair competitive advantage, nor does it represent an attempt to use the assets of the subsidiary banks to obtain a unique competitive status.

The opponents argue that unfair competition between bank holding companies and the independent lessors that must borrow from the subsidiary banks of the same holding companies extends beyond the cost of funds. They allege that holding companies have access to significant confidential information regarding potential competitors, both independents and small dealers that are part of the holding company's indirect network of dealers. Indeed, the opponents suggest, although presenting no evidence to so demonstrate, that indirect leasing programs may simply be a means of making contact with the customers of small dealers so that they may later be transferred to the holding company's direct leasing system.[46] Additionally, they state that by auditing the books of the independent lessors to which loans are granted the holding companies may acquire confidential information concerning the independent lessor's business. As similar information with regard to the bank holding companies

[45] Tr., pp. 169, 190.

[46] Tr., p. 137.

is not available to the independent lessors, the opponents state that they are placed at a competitive disadvantage.[47]

The American Bankers Association ("ABA") responded that it has taken a "strong position" with regard to protecting such information. The ABA also commented upon the fact that the leasing parties did not present a single example of misuse of such information.[48] The California Bankers Association ("CBA") stated that financial information obtained from independent lessors is not, as a matter of law, entitled to the same amount of protection as is individual consumer credit information. Absent "improper use" of such information concludes CBA, bank disclosure of such information to a leasing affiliate is not unlawful.[49] Moreover, the proponents indicated that lines of credit and interest rates are reported in the annual reports of bank holding companies[50] and independent lessors are well aware of the lease terms being offered by banks and bank holding companies through discussions with lessees and bank advertising.[51]

The record reflects that independent lessors have the option of obtaining financing from banks whose affiliates are not engaged in auto leasing.[52] Even borrowing from a bank subsidiary of a holding company that is so engaged results only in divulging information to that particular bank. Absent some sort of information pooling agreement, other bank holding companies would not

[47] Tr., p. 224.

[48] ABA, April 23, 1976, p. 1.

[49] CBA, April 23, 1976, pp. 14-16.

[50] Tr., p. 169.

[51] Tr., p. 232; NADA, April 23, 1976, Appendix A; California Doctors Leasing Service, Inc., April 23, 1976.

[52] Tr., pp. 153, 181, Dick Bullis Car Lease Corp., December 15, 1975.

have access to this data. There has been no allegation that such a pooling arrangement exists. Substantial amounts of information concerning the leasing operations of bank holding companies are publicly available. Although the misuse of confidential information is a possible adverse effect of allowing bank holding company entry into the leasing field, the Board concludes that such possibility should not be accorded significant adverse weight.

The opposing parties also contend that certain intrinsic qualities of the banking business also allow holding companies an unfair advantage. Banking has associated with it a shield of respectability that no other business may obtain[53] and banks can offer such inducements to prospective lessees as free checking accounts or safe deposit boxes.[54] The proponents respond that, to the extent consumers desire a lease package that includes maintenance and repair work, independent lessors have a significant advantage over bank holding companies as the latter are not permitted to offer such services.[55]

Although the Board is concerned about subsidiary banks offering their holding company affiliates services without compensation and has, in fact, directed its staff to prepare a general study of this issue for Board consideration, the competitive effect of free checking or free safe deposit boxes as an inducement to lease an automobile appears *de minimis*. Bank holding companies are not permitted to offer a variety of services provided by independent lessors such as maintenance and repair work, the provision of "loaner" automobiles while the leased vehicle is being repaired, the purchase of insurance for

[53] American Imported Automobile Dealers Assoc., April 22, 1976, p. 7.

[54] SW, December 15, 1975, p. 8.

[55] Seattle-First National Bank, April 20, 1976, p. 5.

the lessee, the sale of auto accessories, and the maintenance of inventories of vehicles. When compared to these services, the offer of free checking or a free safe deposit box would not appear to give a holding company an unfair competitive advantage. Furthermore, the Board notes that such services apparently are offered only in isolated instances, most likely when the bank itself leases and not the bank holding company.

The opponents claim that holding companies may tie leasing services to other banking services. The proponents contend that the participation of holding companies in the leasing market may, in fact, prevent tying by other entities. As an example, it is said that auto dealers may be tempted to write leases requiring that all maintenance work be performed by that dealer. Further, small dealers may be required to finance their leasing activities with funds obtained from auto manufacturers. These manufacturers could tie the provision of such credit to other financial services such as floor plan financing for the dealer's inventory. Thus, it is said, allowing holding companies to engage in leasing will provide an alternative source of financing and thereby discourage this type of tying.[56] The proponents also note that section 106 of the Bank Holding Company Act prohibits the tying of services by banks and bank holding companies.[57]

The Board is of the view that it is not necessary for holding companies to engage in auto leasing in order to act as an alternative source of financing and thereby discourage tying in other segments of the industry. Such an effect could just as well be achieved through more traditional forms of extending credit. Consequently, it does not appear that any public benefits will be generated in this regard through holding company entry. With

[56] Tr., p. 86.

[57] Tr., p. 87.

respect to possible adverse effects, section 106 of the Bank Holding Company Act provides a deterrent to holding company tying as it enables any person injured by such tying to bring a civil action for treble damages plus reasonable attorney's fees. Furthermore, the record of this proceeding is devoid of any examples of such tying and the Board believes that the unsubstantiated possibility of such tying does not constitute a significant adverse effect of bank holding company entry to this field.

With respect to the question whether performance of the activity may lead to decreased competition, the opponents point out that bank economic forecasters predicted in 1973 that entry of bank holding companies into the auto leasing field would produce a high mortality rate among smaller independent lessors. They contend that these small independent auto dealers offer true competitive alternatives in contrast to the automobile dealers involved in indirect leasing that offer the same single bank leasing program and are merely "economic vassals" of bank holding companies.[58] The opponents argue that, if holding companies seriously wish to encourage competition, they have but to make their wholesale lease financing lines available to the smaller auto dealers, thus allowing such dealers to compete independently without relying on a holding company's indirect leasing program. Holding companies are unlikely to offer wholesale lease financing to small dealers, however, if holding companies are permitted to engage in leasing themselves.[59] Rather than allowing smaller dealers to compete as independent lessors, the opponents contend that bank holding companies have entered the direct and indirect leasing fields on a massive scale and have expanded rapidly. The pres-

[58] NADA, December 22, 1975, pp. 21-22.

[59] NADA, April 23, 1976, p. 19.

ence of banks and bank holding companies has increased with such speed in California, where much of the nation's auto leasing occurs, that in a short time several banks have acquired a larger market share than any independing lessor has after 30 years of operation, according to the leasing parties.[60] In the State of Washington, Seattle-First National Bank has achieved a sizeable market share after only two years.[61]

The opponents further contend that rapid expansion by holding companies has stifled the vigorous competition that existed beforehand. They state that in San Jose, California, bank lessors have virtually driven the independent lessors out of business.[62] It is asserted that independent lessors in San Jose were able to match the overall price offered to consumers if the residual value factor were included but that they were unable to offer monthly payments as low as those offered by banks.[63] Opponents contend that the auto leasing market share of California bank holding companies, 49 per cent, coupled with their predatory pricing tactics, will result in the destruction of the independents. Thereafter, it is said, holding companies will raise their prices and obtain monopoly profits. Finally, responding to claims that holding companies must engage in leasing in order to preserve their share of the auto financing market, the opponents state that businesses that merchandise autos must obtain their financing from banks whether those businesses sell or lease autos.[64]

The proponents dispute the assertion that the independent lessors will be driven out of the market. They

[60] SW, December 15, 1975, p. 8.

[61] Ibid.

[62] Tr., p. 222.

[63] Tr., p. 123.

[64] Tr., p. 153.

point out that the history of the provision of consumer credit does not indicate that banks have displaced other consumer credit granting entities. After years of financing the sale of automobiles, banks in California finance only 49 per cent of those sold. By analogy one would not expect independent lessors to be displaced as a general matter.[65] The banking parties also allege that, although a considerable number of bank holding companies have entered the leasing field, the growth of such leasing by banks and bank holding companies has not kept pace with that of independent lessors.[66]

The proponents argue that, in order to control the auto leasing market and drive out independent lessors, bank holding companies would be required to engage in a conspiracy to deny funds to independent lessors. In fact, one bank engaged in leasing stated that in 1975 it helped to finance the operations of 97 independent lessors with loans of $195 million.[67] Further, unless accompanied by a withdrawal of alternative sources of funds such as General Motors Acceptance Corporation, any conspiracy to deprive independents of funding would be ineffective.[68] The proponents argue that, although NADA has contended for a number of years that independent lessors will be driven out of the market, it has produced no evidence to support this claim.[69]

As noted above, the Board has determined that large independent lessors have approximately the same cost for borrowed funds as bank holding companies; that any disparity between the cost of such funds for holding

[65] Tr., p. 196.

[66] Tr., p. 75.

[67] Tr., p. 172.

[68] Tr., p. 181.

[69] Seattle-First National Bank, March 12, 1976, pp. 18-20.

companies and small independent lessors is probably based on the relative size of holding companies, and that neither the lower cost of borrowed funds for large businesses such as holding companies or large independents, nor the ability of holding companies to avoid borrowing funds by resorting to the securities market, represents an unfair competitive advantage.

Inefficient holding companies will doubtless find themselves unable to compete with large, well-managed independent lessors over the long run. Furthermore, even small independent lessors may have the capacity to be quite competitive because of the restrictions placed on bank holding companies by the personal property leasing regulation, as modified above. Most significantly, holding companies may not provide maintenance or repairs for the vehicles they lease. They may not maintain inventories of cars, sell auto accessories, purchase insurance for their lessees, or provide "loaner" cars while the leased vehicle is being repaired. A segment of the leasing market may well desire these services and the record indicates that independent lessors provide all of these services.[70]

The contentions of the leasing parties that independent lessors will be driven from the leasing market with a resultant decrease in the level of competition appears to be based in part on the assumption that independent lessors face a group of holding companies that are acting in concert to eliminate their competitors by charging artificially low prices to their lessees, by unreasonably raising interest rates on loans made to independent lessors, or by simply refusing to make loans to independent lessors. There is no evidence of record to indicate that banks or bank holding companies are in fact engaged in such a conspiracy. Further, as the proponents have noted,

[70] Tr., pp. 43, 216-218.

the history of the involvement of banks in the area of consumer finance suggests that it is extremely unlikely that banks will charge independent lessors artificially high rates of interest or refuse to make funds available to independents. For example, while banks have routinely and traditionally made direct extension of credit to consumers for the purchase of autos, they continue to make such loans indirectly through auto dealer intermediaries by discounting the notes that dealers have accepted from consumers.

The record does indicate that the automobile leasing industry as a whole has grown with considerable rapidity in recent years and that some holding company operations have become quite large. However, the statement by the opponents that holding companies now control 49 per cent of the leasing market in California appears to represent a misunderstanding of the observation that after many years of financing the sale of new cars banks have only 49 per cent of that segment of the financial industry.

In view of the above, the Board believes that independent lessors will continue to exist as strong competitors in the automobile leasing market. Further, there is no evidence of record to suggest that bank holding companies are not competing among themselves in this area, just as they do in other banking and nonbanking fields. The Board concludes that automobile leasing by bank holding companies, or banks, has not had anticompetitive effects in the past and is unlikely to result in decreased competition in the future.

The record does not provide sufficient data for the Board to conclude that bank holding company automobile leasing has had large procompetitive effects in the past. Nevertheless, the Board concludes that the addition to the total number of competitors that results from bank holding company entry as well as the innovation and

increased competition which bank holding companies may offer can be reasonably expected to have procompetitive results, and there is some evidence of lower lease rates as a result of bank holding company entry.[71]

With respect to the issue of whether performance of the activity by bank holding companies will lead to possible unsound banking practices, the opponents state that, notwithstanding claims that bank holding company lessors are protected by their analysis of the creditworthiness of the lessee and the guarantee provision of open-end leases, the major factor in the success of an auto leasing of leased vehicles. It is said that even open-end leases business is the accurate projection of the residual value of leased vehicles. It is said that even open-end leases involve a substantial risk if the lessor makes an overly optimistic estimate of the residual value.[72] A considerable amount of expertise is required to make such estimates accurately, and this expertise is normally not possessed by bank holding companies. Consequently, auto leasing is said to involve a high degree of risk that endangers the capital adequacy of banks and holding companies.[73]

The opponents state that holding companies make unreasonable estimates of residual values so that the consumer's monthly payments may be artificially reduced.[74] They contend that since the Consumer Leasing Act shifts all of the risk involved in estimating the residual value to the lessor, the failure of holding companies to estimate residual value reasonably represents an unsound banking practice.[75] Even absent the Consumer Leasing Act, the leasing parties state that it is difficult to enforce a lessee

[71] Tr., p. 188.

[72] NADA, December 22, 1975, pp. 22-23.

[73] Id., pp. 21-23.

[74] Tr., pp. 42, 58.

[75] NADA, April 23, 1976, pp. 19-20.

guarantee provision due to the costs involved in litigation and the hesitancy of courts to rule in favor of the lessor in view of his superior knowledge of probable residual values.[76]

The proponents contend that holding companies utilize higher standards in assessing the creditworthiness of potential lessees than is the case with those who wish to finance the purchase of an auto.[77] Residual values are estimated conservatively, using the same basic methods applied by banks in all secured lending involving autos.[78] Banks with up to 12 years experience in auto leasing indicated that their percentage of delinquent accounts, total dollar losses per repossessed vehicle, and total number of autos repossessed has been relatively low, in most cases roughly comparable with their auto sales financing operations.[79]

The proponents state that any temptation to reduce the lessee's monthly payment by estimating an imprudently high residual value is counterbalanced by the associated reduction in the lessor's yield. Finally, proponents contend that the lessee's liability is not limited by the Consumer Leasing Act if the lessor makes a reasonable estimate of the residual value based on information available at the time the lease is written.[80]

It is the Board's judgment that the Consumer Leasing Act has a significant effect on the potential for abuse associated with an automobile leasing transaction. As discussed above, this Act provides that lessors are required to make a reasonable estimate of the residual

[76] Tr., pp. 51-52.

[77] Tr., p. 12.

[78] Tr., pp. 8-18, 71-72, 175.

[79] Tr., pp. 12, 74, 165, 176, 178.

[80] Seattle-First National Bank, April 20, 1976.

value of leased property. To the extent the estimated residual value exceeds the actual residual value by more than three monthly payments, the Act creates a rebuttable presumption that the estimate is unreasonable and was not made in good faith. The Act further provides that such excess liability may not be collected except by mutual agreement or through litigation and that in such litigation the lessor is required to pay the lessee's reasonable attorney's fees unless the reason for the failure to accurately project the residual value is due to excessive wear and use of the vehicle by the lessee.

It does not appear that the provisions of this Act will result in unsound banking practices, however, as they will substantially reduce any tendency to overestimate residual value in order to create lower monthly payments. The low level of losses historically associated with bank and bank holding company leasing also diminishes the possibility that the Consumer Leasing Act will have significant adverse effects on the automobile leasing operations of banking companies and support statements by the banking parties that residual values are estimated in a conservative manner. The Board finds that the estimation of residual values is not an inherently unsafe activity and that holding companies have made such estimates in a reasonable manner that cannot be said to represent an unsound banking practice.

The opponents further contend that the low rates of interest at which holding companies provide funds to their leasing subsidiaries represent an unsound banking practice. If fair interest rates were charged, they argue, the supposed profits of leasing subsidiaries would be deflated and might even become losses.

The Board is unable to discern how the use of low interest rates for intracompany transfers of funds could represent an unsound banking practice. First, the subsidiary banks themselves are protected from abuse by the provisions of Section 23A of the Federal Reserve Act. Secondly, low interest loans by the holding company to subsidiaries cannot significantly alter the appearance of consolidated financial statements for purposes of determining profit and loss.

With respect to the question whether bank holding company performance of leasing activities can be reasonably expected to produce benefits to the public such as increased convenience, the opponents contend that, if properly performed, auto leasing involves the provision of a variety of services to accompany the leasing transaction.[81] These services include consumer counseling, maintenance and repair work, arranging for insurance coverage, provision of free "loaner" cars while the leased vehicle is being repaired, sale of auto accessories, sale and purchase of used vehicles, and generally keeping abreast of market developments to assure consumers that they receive the best possible price. The opponents argue that bank holding companies are either not allowed to offer these services or, in the case of consumer counseling, not qualified, and conclude that holding company lessors are not adequately serving the needs of their customers.[82]

The Board concludes that the fact that holding companies are not permitted to offer certain services does not indicate that their participation in the market does not lead to greater convenience for the public. The Board regards holding company leasing as representing an alternative to, rather than a replacement of, the type of leasing performed by independent lessors. Allowing bank holding companies to offer leasing services will create more leasing outlets for the consumer. The elimination of the limited type of leasing transaction offered by hold-

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[81] Tr., pp. 212-220.

[82] NADA, April 23, 1976, p. 14; SW, December 15, 1976.

ing companies would be particularly undesirable in areas that have no independent lessors or whose needs are not adequately served by existing independent lessors.

The questionable nature of the claim that the limited type of leasing offered by holding companies does not adequately serve the public is emphasized by the fact that holding company leasing is intended to be the functional equivalent of an extension of credit. It has not been suggested, for example, that bank financing of auto sales is somehow inadequate because it does not include the type of services provided by auto dealers. Thus, the Board concludes that performance of the activity by bank holding companies will have benefits to the consumer in terms of increased convenience.

The opponents contend that some holding companies do not attempt to purchase autos at the lowest available price and consequently, do not offer consumers the full benefits of leasing.[82] Conversely, holding companies are said to deceive consumers by offering lower monthly payments on the basis of artificially high residual values with the result that consumers are required to make a substantial deficiency payment at the end of the lease term.[84] Proponents contend that some holding companies purposefully avoid paying the lowest possible price for the automobiles they purchase for lease because to do so would have an adverse effect on the quality of the warranty work performed for the lessor by the automobile dealer that sells it.[85] Proponents further argue that they have not overestimated residual values, and offer examples from their own experience to demonstrate that their estimates have been reasonable.[86] Furthermore, even if

[83] Tr., pp. 213-214.

[84] Tr., p. 238.

[85] Tr., p. 99.

[86] Tr., pp. 9, 72.

such practice had existed, the Consumer Leasing Act would have the effect of severally restricting it.

The Board believes that consumers should be allowed to choose between lease plans that provide differing amounts of additional or incidental services and determine how many or how few services to pay for. Such an increase in selection provides positive benefits to the consumer and it is reasonably expected that performance by bank holding companies of the activity will lead to such benefits.

With further reference to the questions of increased convenience and competition, the opponents state in response to claims that the indirect leasing programs of bank holding companies benefit small automobile dealers and create additional sources of leasing services, that any benefits which may accrue to dealers that are enabled to engage in leasing through indirect leasing programs are undermined to the extent that the same holding company is permitted to engage in direct leasing in competition with the independents.[87] Further, they contend that the individual dealer in an indirect leasing program is not a separate competitor providing an alternative source of leasing services to the consumer because the holding company funding the indirect leasing program is the only actual competitor.[88]

The proponents contend that holding company leasing has markedly increased the number of auto dealers that are able to offer leasing and, thus, the number of leasing outlets. Seattle-First National Bank states that 300 of the approximately 480 new car dealers in the State of Washington utilize its indirect leasing program,[89] while

[87] Tr., p. 114.

[88] NADA, April 23, 1976, pp. 18-19.

[89] Tr., p. 8.

Wells Fargo Bank states that in 1975 it was providing indirect lease financing through 750 dealerships that wrote a total of 17,000 leases.[90] The proponents argue that were it not for this type of leasing arrangement small dealers would be unable to provide auto leasing and the public's alternatives would be significantly diminished.[91]

Furthermore, proponents state that holding company leasing has not precluded other types of auto financing; that banking subsidiaries continue to extend credit to finance both new car sales and the operations of independent lessors.[92] Moreover, dealers that utilize indirect leasing programs receive their profit more rapidly than is the case with conventional financing.[93] They contend that by providing an alternative to conventional financing, leasing also allows dealers to garner increased sales.[94] Additional public benefits arise through holding company leasing in rural areas that would otherwise have no leasing outlets.[95] Finally, proponents state that in some areas of the country holding company leasing has resulted, or is expected to result, in lower costs to consumers.[96]

In the Board's judgment, in view of the history of the involvement of banks in the area of consumer finance, it is unlikely that a holding company's addition of a direct leasing plan to an indirect program will have a negative impact on dealers participating in the indirect

[90] Tr., p. 173.

[91] Seattle-First National Bank, March 12, 1976, pp. 18-20.

[92] Tr., pp. 13, 171-73, 201-202.

[93] Tr., p. 16.

[94] Tr., p. 83.

[95] Tr., p. 80.

[96] Tr., pp. 26, 188.

program. Banks have demonstrated that they are prepared to utilize several methods of financing the same type of transaction and it seems reasonable to expect that they will do so in the leasing area also. The record indicates that in practice direct and indirect methods of holding company leasing are not incompatible.[97] Moreover, allowing direct leasing provides additional locations at which a lease may be obtained and is therefore more convenient for the consumer. Direct leasing by bank holding companies also adds a completely independent competitor to the market.

The contentions of opponents that auto dealers participating in indirect leasing plans are not independent competitors are undermined by the fact that dealers may participate in several plans at once. It does, however, appear reasonable to assume that dealers involved in only one such plan are not independent competitors and might be more accurately described as agents for a particular holding company. Despite this, it must be noted that even in this instance, the holding company is added to the number of competitors in the market served by the dealer. By participating in several indirect leasing programs, the dealer may gain a certain degree of independence and additional holding companies may become competitors in the dealer's market area.

More significantly, the large number of leasing outlets associated with an indirect leasing plan is clearly more convenient for the public, particularly in areas that cannot support an independent leasing operation. Thus the Board is of the view that bank holding company leasing, whether of the direct or indirect type, provides a significant public benefit in terms of greater convenience for the community to be served, and provides a benefit in terms of increased competition.

[97] Tr., p. 71.

With regard to the issue of whether holding company auto leasing will create gains in efficiency, the opponents contend that bank holding companies are not leasing experts and therefore cannot create such gains. Proponents respond that by using the centralized facilities of a bank holding company, small auto dealers are able to substantially reduce the cost of administering a leasing program and that the resulting savings may be passed on to the consumer.

The Board is of the view that the contention of the opponents that holding companies cannot create greater efficiencies because they are inexperienced in leasing is dubious in view of the fact that national banks have been permitted to engage in auto leasing since 1963, and many have experience that can be transferred to their parent holding companies. Moreover, holding companies have been involved in the related field of auto finance for decades. Accordingly, the Board concludes that banks and bank holding companies have had significant experience in the administration of automobile leasing and automobile sales financing programs and that gains in efficiency can reasonably be expected to result from making this expertise available to small automobile dealers through indirect leasing programs.

On the basis of the foregoing, the Board concludes that automobile leasing is closely related to banking or managing or controlling banks. The Board has further determined that performance of this activity by an affiliate of a holding company can reasonably be expected to produce benefits to the public which outweigh possible adverse effects and that the activity is, therefore, a proper incident to banking or managing or controlling banks. The Board has therefore determined that bank holding companies should be allowed to continue to conduct automobile leasing activities in a manner consistent with the Board's personal property leasing regulation. The Board

has, however, determined in accordance with the above discussion, that it would be appropriate to provide a further definition of the requirement that a lease be on a nonoperating basis. Accordingly, pursuant to section 4(c)(8) of the Bank Holding Company Act, the Board has decided herein to amend its personal property leasing regulation.

(1) Effective October 13, 1976, section 225.4(a)(6) is hereby amended by adding a new footnote 4 at the end of paragraph 225.4(a)(6)(iii) to read as follows:

SECTION 225.4—NONBANKING ACTIVITIES

(a) Activities closely related to banking or managing or controlling banks. * * *

* * * *

(6)(a) Leasing personal property or acting as agent, broker or adviser in leasing such property provided:

* * * *

(iii) the lease is on a nonoperating basis;[4]

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[4] For purposes of the leasing of automobiles, the requirement that the lease be on a nonoperating basis means that the bank holding company may not, directly or indirectly, provide for the servicing, repair or maintenance of the leased vehicle during the lease term; purchase parts and accessories in bulk or for an individual vehicle after the lessee has taken delivery of the vehicle; provide for the loan of an automobile during servicing of the leased vehicle; purchase insurance for the lessee; or provide for the renewal of the vehicle's license merely as a service to the lessee where the lessee could renew the license without authorization from the lessor.

(2) As an incident to this amendment, footnotes 4 to 12 are redesignated 5 to 13.

By order of the Board of Governors, effective October 13, 1976.

/s/ Theodore E. Allison
THEODORE E. ALLISON
Secretary of the Board

[SEAL]

APPENDIX B

Judgment of Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

SEPTEMBER TERM, 1977

[No Opinion]

No. 76-2021

NATIONAL AUTOMOBILE DEALERS ASSOCIATION, INC.,
Petitioner

v.

THE BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Respondent

[Filed Feb. 21, 1978]

Petition for Review of an Order of the Board of Governors of the Federal Reserve System.

Before: WRIGHT, TAMM, and LEVENTHAL, Circuit Judges.

JUDGMENT

This cause came on to be heard on a petition for review of an order of the Board of Governors of the Federal Reserve System and was argued by counsel. While the issues presented occasion no need for an opinion, they

have been accorded full consideration by the court. *See* Local Rule 13(c).

Respondent's regulations under review are predicated in substantial part on its assumption that they will increase competition without jeopardizing the viability of petitioner's members as competitors. Given that assumption, this court is in general agreement with the reasons stated by respondent in support of its order. *See* 41 Fed. Reg. 45977 (Oct. 19, 1976).

On consideration of the foregoing, it is ORDERED and ADJUDGED by this court that the order of the Board of Governors sought to be reviewed herein is hereby affirmed. If in petitioner's view the Board's assumption proves to be false, it may file a motion with the Board to amend or vacate its order in this case. If petitioner is dissatisfied with respondent's disposition of its motion, it may move to reopen this appeal.

Per Curiam

For the Court

/s/ George A. Fisher
GEORGE A. FISHER
Clerk

APPENDIX C

Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(c)(8) (1970):

> (c) The prohibitions in this section shall not apply to any bank holding company which is (i) a labor, agricultural, or horticultural organization and which is exempt from taxation under section 501 of Title 26, or (ii) a company covered in 1970 more than 85 per centum of the voting stock of which was collectively owned on June 30, 1968, and continuously thereafter, directly or indirectly, by or for members of the same family, or their spouses, who are lineal descendants of common ancestors; and such prohibitions shall not, with respect to any other bank holding company, apply to—
>
> * * * *
>
> (8) shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced *de novo* and activities commenced by acquisition, in whole or in part, of a going concern; . . .

Consumer Leasing Act, 15 U.S.C. § 1667b(a) (Supp. VI, 1976):

> (a) Where the lessee's liability on expiration of a consumer lease is based on the estimated residual value of the property such estimated residual value shall be a reasonable approximation of the anticipated actual fair market value of the property on lease expiration. There shall be a rebuttable presumption that the estimated residual value is unreasonable to the extent that the estimated residual value exceeds the actual residual value by more than three times the average payment allocable to a monthly period under the lease. In addition, where the lessee has such liability on expiration of a consumer lease there shall be a rebuttable presumption that the lessor's estimated residual value is not in good faith to the extent that the estimated residual value exceeds the actual residual value by more than three times the average payment allocable to a monthly period under the lease and such lessor shall not collect from the lessee the amount of such excess liability on expiration of a consumer lease unless the lessor brings a successful action with respect to such excess liability. In all actions, the lessor shall pay the lessee's reasonable attorney's fees. The presumptions stated in this section shall not apply to the extent the excess of estimated over actual residual value is due to physical damage to the property beyond reasonable wear and use, or to excessive use, and the lease may set standards for such wear and use if such standards are not unreasonable. Nothing in this subsection shall preclude the right of a willing lessee to make any mutually agreeable final adjustment with respect to such excess residual liability, provided such an agreement is reached after termination of the lease.

APPENDIX D

Regulation

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12 C.F.R. § 225.4(a)(6)(i)(1977):

> (a) *Activities closely related to banking or managing or controlling banks.* In accordance with the procedures set forth in paragraphs (b) and (c) of this section, any bank holding company may engage, or retain or acquire an interest in a company that engages, solely in one or more of the activities specified below, including such incidental activities as are necessary to carry on the activities so specified. Any bank holding company that is of the opinion that other activities in the circumstances surrounding a particular case are closely related to banking or managing or controlling banks may file an application in accordance with the procedures set forth in paragraph (b)(2) of this section. As to such an application, the Board will publish in the FEDERAL REGISTER a notice of opportunity for hearing only if it believes that there is a reasonable basis for the holding company's opinion. The following activities have been determined by the Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto:
>
> (6) (i) Leasing personal property or acting as agent, broker or adviser in leasing such property provided:
>
> (*a*) The lease is to serve as the functional equivalent of an extension of credit to the lessee of the property;
>
> (*b*) The property to be leased is acquired specifically for the leasing transaction under considera-

tion or was acquired specifically for an earlier leasing transaction;

(*c*) The lease is on a nonoperating basis;[4]

(*d*) At the inception of the initial lease the effect of the transaction (and, with respect to governmental entities only, reasonably anticipated future transactions)[5] will yield a return that will compensate the lessor for not less than the lessor's full investment in the property plus the estimated total cost of financing the property over the term of the lease,[6] from: (*1*) Rentals; (*2*) estimated tax benefits (investment tax credit, net economic gain from tax deferral from accelerated depreciation, and other tax benefits with

[4] For purposes of the leasing of automobiles, the requirement that the lease be on a nonoperating basis means that the bank holding company may not, directly or indirectly, provide for the servicing, repair or maintenance of the leased vehicle during the lease term; purchase parts and accessories in bulk or for an individual vehicle after the lessee has taken delivery of the vehicles; provide for the loan of an automobile during servicing of the leased vehicle; purchase insurance for the lessee; or provide for the renewal of the vehicle's license merely as a service to the lessee where the lessee could renew the license without authorization from the lessor.

[5] The Board understands that some Federal, State and local governmental entities may not enter into a lease for a period in excess of one year. Such an impediment does not prohibit a company authorized under § 225.4(a) from entering into a lease with such governmental entities if the company reasonably anticipates that such governmental entities will renew the lease annually until such time as the company is fully compensated for its investment in the leased property plus its costs of financing the property. Further a company authorized under § 225.4(a)(6) may also engage in so-called "bridge" lease financing of personal property, but not real property, where the lease is short term pending completion of long term financing, by the same or another lender.

[6] The estimate by the lessor of the total cost of financing the property over the term of the lease should reflect, among other factors, the term of the lease, the modes of financing available to the lessor, the credit rating of the lessor and/or the lessee, if a factor in the financing, and prevailing rates in the money and capital markets.

a substantially similar effect); (*3*) the estimated residual value of the property at the expiration of the initial term of the lease, which in no case shall exceed 20 percent of the acquisition cost of the property to the lessor; and (*4*) in the case of a lease of not more than 7 years in duration, such additional amount, which shall not exceed 60 percent of the acquisition cost of the property, as may be provided by an unconditional guarantee by a lessee, independent third party or manufacturer, which has been determined by the lessor to have the financial resources to meet such obligation, that will assure the lessor of recovery of its investment and cost of financing;

(*e*) The maximum lease term during which the lessor must recover the lessor's full investment in the property plus the estimated total cost of financing the property shall be 40 years; and

(*f*) At the expiration of the lease (including any renewals or extensions with the same lessee), all interest in the property shall be either liquidated or released on a nonoperating basis as soon as practicable but in no event later than two years from the expiration of the lease,[7] however, in no case shall the lessor retain any interest in the property beyond 50 years after its acquisition of the property.

[7] In the event of a default on a lease agreement prior to the expiration of the lease term, the lessor shall either re-lease such property, subject to all the conditions of this subsection 6(a), or liquidate such property as soon as practicable but in no event later than two years from the date of default on a lease agreement.